

## INTRODUCTION

*Owen L. Anderson\**

In 2006, energy issues received the greatest amount of scrutiny from the media and the public since the 1970s. Attention focused on a variety of specific concerns, such as renewable energy, energy geopolitics, the economic impact of high energy costs, and the environmental impact of energy operations. But the underlying concern, not surprisingly, is oil. Oil is the most important and valuable international commodity, and because it is finite, it has been regarded as strategically important, at least since the 1910s, when the United States and Great Britain began converting their naval vessels from coal to oil power. Because oil is both finite and strategic, it can also be corrupting. This Issue and the Journal's prior International Energy Issue address all three of these oil characteristics.

Because oil is finite, public policy requires conservation. Historically in the United States, the rule of capture allowed each owner in a common reservoir to exploit the common oil reservoir without liability to other owners. Courts regarded the rule of capture as both fair and efficient because each owner was given the opportunity, through self-help drilling, to recover a share of the oil. Unfortunately, the rule of capture led to the waste of both oil and money. When the magnitude of this waste became apparent in the 1930s, critics of the rule of capture supported federal preemption of state law and mandatory unitization. Although federal preemption did not occur, Congress did approve the establishment of the Interstate Oil Compact Commission—a compact among producing states to regulate oil production. Unfortunately, largely due to a lack of political courage, most states have yet to implement a sensible

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\* Eugene Kuntz Chair in Oil, Gas & Natural Resources, The University of Oklahoma College of Law; Senior Fellow, University of Melbourne Faculty of Law; Principal Research Fellow, University of Dundee Centre for Energy, Petroleum & Mineral Law & Policy.

unitization policy or law. Fortunately, most oil producing nations embrace unitization as a desirable policy.

In the prior International Energy Issue, Professor Jacqueline Lang Weaver and David Asmus of Baker Botts L.L.P. addressed unitization in the context of a common reservoir that crosses contract area boundaries within a single nation. Since the publication of their article, *Unitizing Oil Fields Around the World: A Comparative Analysis of National Laws and Private Contracts*,<sup>1</sup> the Association of International Petroleum Negotiators has completed work on a model unitization agreement patterned after its widely used model joint operating agreement. Both the Weaver-Asmus article and the new model unitization agreement will contribute to efficient unit operations for the optimal recovery of finite oil.

Just as oil reservoirs ignore contract boundaries, oil reserves also ignore established international boundaries or can serve as the catalyst for a boundary dispute—underscoring oil's finite and strategic characteristics. Two scenarios raise geopolitical concerns: a reservoir that crosses an international boundary and a reservoir that is wholly or partially within an area claimed by two or more nations. In this Issue, Professor Thomas Wälde, Salim Mahmud, Adaeze Ifesi, and Dr. Elizabeth Bastida describe and analyze the solutions of cross-border unitization and joint development zones as a means of managing these scenarios.

Hundreds of unresolved international boundary disputes continue both onshore and offshore. Although the 1958 Geneva Convention on the Continental Shelf anticipated development at water depths of 200 meters, oil companies now explore in remote land areas, as well as in deeper and deeper waters, now approaching 4,000 meters. Deep-water drilling increases the likelihood that newly discovered reservoirs may encroach on disputed areas, may cross international boundaries, or may even lie beneath the high seas. Due to geopolitics, the solutions must address the particular circumstances. The authors explore and

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1. Jacqueline Lang Weaver & David Asmus, *Unitizing Oil and Gas Fields Around the World: A Comparative Analysis of National Laws and Private Contracts*, 28 HOUS. J. INT'L L. 3 (2006).

discuss the fundamentals of international law relating to these various scenarios and discuss cross-border unitization and joint development zones, which, although not yet obligatory under international law, are nevertheless necessary practical solutions to help assure the fair and maximum ultimate recovery from cross-border reservoirs.

Because oil is valuable, finite, and strategic, it can have a corrupting influence on both public officials and private stakeholders. Unfortunately, second only to the armaments industry, the extractive industries are perceived to be the biggest perpetrators of corruption on the supply side. These industries are also victims of corruption from the demand side. The passage of the extraterritorial United States Foreign Corrupt Practices Act in 1977 (FCPA) made the bribery of foreign officials a federal crime and ended the tax deductibility of bribes. By 1997, the Organization for Economic and Cooperative Development had adopted the Convention on Combating Bribery of Foreign Officials in International Business Transactions, which entered into force in 1999. Shortly thereafter, the United Nations adopted its Convention Against Corruption in 2003, which entered into force in 2005, and several other international organizations also advanced anticorruption initiatives. The United Kingdom has taken the lead to further address the problem of corruption by backing the Extractive Industries Transparency Initiative (EITI).

The FCPA and similar antibribery laws do not apply to revenues paid legitimately to a host government, such as signing bonuses or production royalties. The EITI indirectly, but effectively, addresses the corrupting influence of legitimate payments to host governments by promoting transparency regarding the payment of revenues to, and their receipt by, host governments. The EITI seeks to encourage private investors to disclose revenues paid to host governments for oil, gas, and mining investments. The EITI further encourages host governments to disclose to the public the receipt of such revenues and to have the payments and receipts independently verified and reconciled. Backers of EITI believe that these disclosures will also lead to greater transparency of host-government budgetary and investment processes. While not directly addressing corruption, transparency should deter

embezzlement and encourage more thoughtful expenditures and investment of revenues, thus helping to assure that host-government economies will better benefit, both in the short and long term, from foreign investment in energy and mineral resources. Historically, many host governments rich in natural resources have remained poor, in part because of corruption and bad decisionmaking regarding the expenditure and investment of natural resource revenues.

Transparency International and Global Watch UK have been at the forefront of many initiatives to deter corruption and to better assure government accountability. Dr. Peter Eigen's address, given in Houston last year<sup>2</sup> and published in this Issue, offers a compelling argument in support of the EITI. The success of this initiative may depend upon whether those resource-consuming governments that have not embraced transparency within their own borders will nevertheless support the initiative when contracting, through their national oil companies, for exploration and development rights with developing nations. Unfortunately, the signs are not encouraging.

In his address, Dr. Eigen referred to what was then an upcoming conference on the EITI, held this past October in Oslo. World Bank President Paul Wolfowitz gave a keynote address and reported on recent progress to combat corruption in Cameroon, Ghana, Kazakhstan, Mauritania, and Nigeria. George Soros, an investor and early supporter of the EITI, also reported progress, but expressed concern that national oil companies, particularly the Chinese and Indian companies, had undermined some of the progress by pursuing resources at "all cost." The conference recommended a plan for states to independently confirm compliance with EITI standards and the establishment of a system to validate the performance of implementing states.<sup>3</sup>

The essays concerning recent developments illustrate four major pitfalls for U.S. oil companies, although foreign companies

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2 Dr. Eigen spoke on April 12, 2006, at the Magnolia Hotel as part of the Houston Journal of International Law's annual lecture series.

3. Press Release, The World Bank, Progress Made in Fight Against Oil Corruption: Conference, <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,date:2006-10-18~menuPK:34461~pagePK:34392~piPK:64256810~theSitePK:4607,00.html>.

may also be vulnerable. Perhaps because it is the most recent and thus not fully developed, Andrew Derman and Andrew Melsheimer raise the most disturbing concern: that U.S. oil companies could face garnishment orders in the United States that, in turn, would put them in breach of their host-government contracts. Although this development seems surreal, it remains a distinct and potentially far-reaching possibility. The essay points out that over seventy developing countries have defaulted on their public debt in the last decade alone. As the authors point out, if garnishment remains a real possibility, debt-prone host governments are likely “to think twice before doing business with a U.S. company.” The debt crisis in various regions of the developing world, especially South America, is one reason for the new wave of nationalism that has brought leaders such as Venezuela’s Hugo Chavez to power. Garnishment of host-government entitlements is certain to fuel the fires of nationalism and expropriations.

Martin Weinstein, an FCPA expert, offers sound advice to lawyers on FCPA due diligence and compliance. He also discusses a lawyer’s professional responsibilities regarding client compliance with export-control and trade-sanction law and client avoidance of the Alien Tort Statute (ATS). Corruption compliance is a concern for all oil, gas, and mining companies because, second only to the armaments industry, they are most likely to be monitored for corrupt activities, and the federal government has greatly increased its enforcement of the FCPA since the Enron scandal and the passage of Sarbanes-Oxley. Thus, U.S. companies need to be especially careful not to raise FCPA compliance concerns. U.S. companies are also more vulnerable to running afoul of export-control and trade-sanction law because the United States readily regulates exports and more frequently imposes trade sanctions than do other countries. While both foreign and domestic companies, as well as individuals, can fall within the scope of ATS subject matter jurisdiction, U.S. companies are more vulnerable because they are more readily subject to service of process and thus to personal jurisdiction in U.S. courts. The adverse publicity of having been accused of a corrupt practice, of violating export-control or trade-sanction law, or of committing or abetting a violation of international law, such as a crime against humanity,

should be sufficient reason to encourage the careful due diligence that Mr. Weinstein counsels.

Edwin Gorham further explores the dangers of falling within the scope of the ATS. He discusses the ATS and the two principal ATS cases concerning oil companies: *Unocal*, involving a U.S. company conducting operations in Myanmar, and *Talisman*, a Canadian company conducting operations in Sudan. He then suggests some practical approaches to minimizing exposure to the ATS.

Richard Leibert's comment on the need for both domestic and international legislation to ensure the security of energy infrastructure further demonstrates the strategic nature of oil. Leibert argues that the United States Maritime Transportation Security Act provides a framework for legislation to safeguard energy infrastructure. He further asserts that the International Atomic Energy Agency's effort to safeguard nuclear security and the International Maritime Organization's effort to safeguard maritime security provide frameworks for the United Nations to address energy security matters on a global scale.

The final comment by James Frederick deals with water. The inclusion of this subject in the current Issue suggests an addition to the quip attributed to Mark Twain that "whiskey's for drinkin' and water's for fightin'." We might add "oil's for exploitin'." Frederick points out that Texas and the Middle East face similar water challenges and have insufficient regulatory schemes in place to assure an affordable and long-term fresh water supply. He argues for the development of a new regulatory paradigm to facilitate privatization of the water sector and for the development of new technologies to increase water supplies.